

***United States Court of Appeals
for the Second Circuit***



**BRIEF FOR
APPELLEE**

77-7049

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United States Court of Appeals

For the Second Circuit.

GEORGE M. OSSERMAN,
Plaintiff-Appellant,

against

BANK LEUMI TRUST COMPANY OF NEW YORK,
Defendant-Appellee.

**Brief for Defendant-Appellee, Bank Leumi Trust
Company of New York.**

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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GEORGE M. OSSERMAN, :
Plaintiff-Appellant, :
-against- :
BANK LEUMI TRUST COMPANY OF NEW YORK, :
Defendant-Appellee. :
-----x

BRIEF FOR DEFENDANT-APPELLEE,
BANK LEUMI TRUST COMPANY OF
NEW YORK

ISSUES PRESENTED

The issues presented in this appeal are as follows:

1. Whether the court acted properly in finding that, upon all the allegations of the complaint, defendant did not fail to exercise the reasonable case required under Section 9-207(1) of the Uniform Commercial Code.
2. Whether the court acted properly as a matter of law in directing judgment in favor of defendant dismissing the complaint.

NATURE OF THE CASE

This action, jurisdiction of which is predicated upon diversity of citizenship, is brought by plaintiff against Bank Leumi Trust Company of New York, formerly known as First Israel Bank & Trust Company. In one count, plaintiff attempts to assert that the defendant, as a secured creditor, acted improperly when, holding collateral securities of plaintiff and one Seymour Gloger ("Gloger"), as guarantors of a loan made to Heritable Security Corporation ("Heritable") under a written guaranty agreement, defendant transferred the securities, including those of plaintiff, to the co-guarantor, Gloger, who paid the loan under his guaranty. As a result of this claimed wrong, plaintiff seeks damages, an accounting and redemption of his securities.

COURSE OF THE PROCEEDINGS

This action was commenced on May 5, 1976 by the filing of the complaint (Appellants' Appendix (hereinafter "A") A-8 to A-21). Thereafter, defendant moved to dismiss the complaint pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure ("FRCP") for failure to state a claim upon which relief can be granted (A-23).

The motion was heard by Judge Inzer B. Wyatt on December 17, 1976 (A-1)* and a memorandum decision, dated January 10, 1977 (A-4 to A-7), was rendered "dismissing the action for failure of the complaint to state a claim upon which relief can be granted" (A-7). Judge Wyatt held, in essence, that since a co-guarantor has the right to take possession of the collateral once he has paid the loan, it was not "unreasonable for the bank to conclude that Gloger had a right to possession of the collateral, even if only as an assignee" (A-7), and "it cannot be said that defendant bank failed to exercise the 'reasonable' degree of care required of it by Section 9-207 of the Code" (A-7).

Judgment in favor of defendant and against plaintiff dismissing the complaint was entered on January 12, 1977 (A-3).

STATEMENT OF THE FACTS

Plaintiff asserts on this appeal that his complaint

*After the motion was heard, plaintiff submitted on December 20, 1976, an affidavit in opposition to the motion, with exhibits (A-24 to A-44). However, Judge Wyatt, in his memorandum decision, does not refer expressly or otherwise to plaintiff's affidavit or to any matter contained therein, and it is clear that he decided the motion only on the complaint and the exhibits annexed thereto.

sets forth a claim against defendant for violation of its "fiduciary duty" (A-11) and obligation to use reasonable care in connection with plaintiff's securities held by defendant as collateral for the loan to Heritable. However, as the very facts alleged by the plaintiff demonstrate, defendant exercised reasonable care, and did not act in contravention of the written guaranty agreement pursuant to which the securities were pledged.

Thus, the complaint alleges that in May, 1970, plaintiff and Gloger entered into a written guaranty agreement with defendant, whereby plaintiff and Gloger guaranteed payment of loans made by defendant to Heritable and pursuant to which plaintiff and Gloger pledged as collateral to secure the loan, their respective shares in a limited partnership known as Womig Associates ("Womig shares") (Complaint, paragraph (hereinafter "Compl. par. ") 4, A-8). The guaranty agreement (A-14) a copy of which is annexed to the complaint states in relevant part:

"We, the undersigned, Seymour Gloger and George M. Osserman, in consideration of the establishment of a line of credit for Heritable Security Corporation up to \$50,000.00 do hereby guarantee to you the payment of the principal sum or sums advanced by you to Heritable Security Corporation plus the interest thereon, all in accordance with the agreement of loan or promissory note or notes to be executed to the bank."

"In order to secure the guarantee hereinabove set forth, we herewith assign to you all of our interest in Womig Associates. In the event of default in the payment of any installment of principal or interest as hereinabove provided, and should such default continue for a period of ten days after notice, then you shall have the right, upon the ten days' written notice to each of us, to sell the said interests in Womig Associates and to apply the proceeds from such sale to the payment of the indebtedness plus the reasonable costs incurred by you. Any surplus will be paid over to us, and any deficiency will be paid by us immediately."

The guaranty agreement has no provision respecting the return of the collateral.

Plaintiff further alleges that in July, 1970, plaintiff and Gloger, who had been equal owners of Heritable (Compl., par. 5, A-9) entered into an agreement whereby they dissolved their partnership in Heritable and plaintiff agreed that the defendant's loan to Heritable was made for plaintiff's benefit personally and for the benefit of Medical Management Services Co., and plaintiff agreed to pay the loan to defendant (Compl., par. 6, A-9). The agreement further provided, it is alleged, that if the plaintiff fails to pay the loan,

"and the Bank shall elect to foreclose on the Womig interests assigned to it, then Gloger shall have the right to purchase the whole of the Womig collateral, including

Osserman's interest therein, by payment to the Bank of the amount sought on said foreclosure." (Compl., par 6, A-9).*

It is averred that a copy of this bilateral agreement was delivered to defendant (Compl., par. 6, A-9) and that thereafter, on March 26, 1971, after plaintiff was in default on the loan, plaintiff's counsel wrote a letter (A-18) to defendant requesting the return of the Womig shares if the loan is paid (Compl., par. 7, A-9, A-10). It is averred that Gloger paid the loan balance of \$26,000 and "in an attempt to usurp ownership of the shares, handed defendant a letter, a copy of which is annexed as Exhibit C, which apprised defendant that he was 'purchasing' the shares and became the owner of them." (Compl., par. 8, A-10). Plaintiff alleges that defendant "refused to accept" the said letter (A-19) and "demanded and received" instead a letter from Gloger stating that the collateral was being released to him "in view of my paying Heritable's loan under my guarantee" (A-20). Plaintiff asserts that Gloger, after receiving the transfer of the plaintiff's shares, wrongfully asserted ownership

*A copy of the agreement was annexed to plaintiff's affidavit in opposition to the motion (A-32 to A-42).

over the Womig shares (Compl., par. 10, A-10), that defendant had only written a letter demanding payment and had never "elected to foreclose" on the Womig shares (Compl., par. 11, A-10), and that although defendant advised Gloger by letter that Gloger had not purchased the shares but had merely become subrogated to the defendant's rights in the collateral (A-21), plaintiff allegedly "aided and abetted Gloger in his assertion of ownership of the shares" (Compl., par. 12, A-11).

Thus, despite the facts that (1) plaintiff did not repay the loan and Gloger did; (ii) defendant allegedly had knowledge of the July 1970 agreement between the guarantors whereby, as between plaintiff and Gloger, plaintiff agreed to be primarily liable on the loan; and (iii) defendant "refused" to sell the Womig shares to Gloger but only transferred them to Gloger under his guaranty and upon his express written representation that he was taking the collateral under his guaranty, plaintiff asserts that the release of the Womig shares was "wrongful" (Compl., par. 15, A-11).

By reason of defendant's claimed dereliction, plaintiff avers that he has been compelled to engage in litigation and arbitration against Gloger since 1972, even

though plaintiff concedes that such litigation involves "extraneous issues, including accountings with respect to the partnerships between plaintiff and Gloger" (Compl., par. 14, A-11). Plaintiff also avers that Gloger has retained dividends received on plaintiff's Womig shares, including those for the year 1970, prior to the transfer, which plaintiff seeks to recover from defendant. Plaintiff further alleges that his shares were sold in 1975 for the sum of \$109,633 and that Gloger has retained this sum (Compl., par. 17, A-12).

It seems clear that if plaintiff has any claim, it is against Gloger.* The defendant plainly acted with the reasonable care required of a secured creditor when it

*Indeed, in plaintiff's action against Gloger in the United States District Court for the District of Massachusetts (A-11), it is a matter of public record that that court in December, 1976, denied plaintiff's motion for partial summary judgment for the return of his Womig shares. That Court interpreted the July 1970 agreement between plaintiff and Gloger to mean that if plaintiff did not repay Bank Leumi's loan to Heritable, then as a penalty to plaintiff, Gloger had the right to ownership of the shares by paying the loan balance. The court interpreted the provision respecting the Womig shares in light of the fact that it was part of a larger agreement dissolving the parties' partnerships. The court held the foregoing to be the law of the case. Obviously, if plaintiff is not entitled to the Womig shares as against Gloger, plaintiff has not been damaged by any alleged act or omission of this defendant.

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transferred the collateral securities to the guarantor who paid the loan. As will be analyzed more fully hereinafter, defendant bank had a duty to preserve the collateral for the guarantor who paid the loan, and under all the circumstances, as the court below stated, it cannot be said that defendant did not exercise the reasonable care required of it.

POINT I

THE COMPLAINT FAILS TO STATE FACTS
SHOWING THAT DEFENDANT DID NOT
EXERCISE THE REASONABLE CARE REQUIRED
UNDER SECTION 9-207(1) OF THE UNIFORM
COMMERCIAL CODE

The complaint was correctly dismissed below since it fails to plead facts showing that defendant did not act in accordance with Section 9-207(1) of the Uniform Commercial Code (McKinney's 1964) ("Code") which applies here and provides that:

"A secured party must use reasonable care in the custody and preservation of collateral in his possession. In the case of an instrument or chattel paper reasonable care includes taking necessary steps to preserve rights against prior parties unless otherwise agreed."

Where a creditor holds security as collateral for a debt for which co-guarantors are bound, section 9-207(1) requires that the secured creditor preserve the collateral for the use of the guarantor who pays the loan as against the principal debtor and co-guarantors who may be liable to him for all or any part of the amount paid. See Gutekunst v. United States, 8 UCC Reporting Service, p. 1372 (S.D.N.Y. 1971) (Motley, J.). The principle underlying this duty, and which continues to be viable under the Code by virtue of

sections 1-103 and 9-504(5)*, has been stated thusly:

"The broad doctrine is laid down that 'the surety, by the mere payment of the debt, and without any actual assignment from the creditor is, in equity, subrogated to all the rights and remedies of the creditor, for the recovery of his debt against the principal debtor or his property, or against the co-sureties or their property, to the extent of what they are equitably bound to contribute.'" Townsend v. Whitney, 75 N.Y. 425, 431 (1878)

In this regard, the right of a guarantor upon payment of the debt includes a right, enforceable by the courts, to an assignment by the creditor of all collateral securities held for the debt. Mathews v. Aikin, 1 N.Y. 595, 600-601 (1848); National Savings Bank of the City of Albany v. Fermac Corporation, 241 App. Div. 204 (3d Dept.), aff'd, 266 N.Y. 443 (1934); Niagara County National Bank and Trust Company v. La Port, 233 App. Div. 501 (4th Dept. 1931); Kirby v.

*UCC §1-103 provides in relevant part:

"Unless displaced by the particular provisions of this Act, the principles of law and equity...shall supplement its provisions."

UCC §9-504(5) provides:

"A person who is liable to a secured party under a guaranty, indorsement, repurchase agreement or the like and who receives a transfer of collateral from the secured party or is subrogated to his rights has thereafter the rights and duties of the secured party. Such a transfer of collateral is not a sale or disposition of the collateral under this Article."

Barlow, 33 Misc. 254 (Sup. Ct., N.Y. Co. 1900), aff'd, 60 App. Div. 630 (2d Dept. 1901).

Thus, in Kirby two co-sureties each pledged his own securities to a creditor for the payment of a debt. Upon the principal debtor's default, one co-surety paid the entire debt and received a transfer from the creditor of all the collateral including that of his co-surety, who thereupon sued for the return of his security. The Court stated that by paying the debt, the co-surety becomes an equitable assignee of all the securities held by the creditor for the debt and is entitled to have all of them assigned to him. The Court dismissed the complaint stating that the plaintiff and defendant being co-sureties, plaintiff was required to pay his portion of the debt before he would be entitled to the return of the securities.

This right of the surety upon paying the debt to demand the collateral held by the creditor arises by operation of law and "grows out of the relation existing between the surety and the creditor..." 57 N.Y. Jur. Suretyship and Guaranty, §325, at 764 (1967) (emphasis added); Kolb v. National Surety Co, 176 N.Y. 233 (1903).* Consequently,

*UCC§1-201(40) provides that the term "surety" includes a guarantor.

a secured creditor who has compelled a guarantor to pay the debt may not thereafter question the right of the guarantor to take an assignment of the security held as collateral for the debt. Mathews v. Aikin, supra; Smith v. National Surety Co., 28 Misc. 528. (Sup. Ct., Monroe Co.), aff'd, 46 App. Div. 633 (4th Dept. 1899):

"If the creditor has insisted upon the surety's discharging his obligations and liabilities as such..., he cannot, after receiving from him his debt, turn round and deny him the rights of a surety. The creditor must then fulfill his obligation to the surety, and leave the latter and his principal to adjust or litigate their rights to claims as they may see fit." Mathews v. Aikin, supra, at 605.

In light of the foregoing, it is clear that defendant acted with reasonable care in transferring the shares to Gloger, the guarantor who paid the loan. In this regard, also, plaintiff's claim that defendant acted in contravention of the guaranty agreement is without merit since the above stated principles and the duty imposed upon the secured creditor flowing therefrom, arise by operation of law and nothing in the guaranty agreement precludes their application (supra, pp. 4, 5, 12).

Indeed the foregoing principles are particularly apposite here where plaintiff alleges that as between he and

Gloger, he agreed to be primarily liable on the loan and that defendant had notice of this arrangement (Compl., par. 6, A-8). While an agreement between co-guarantors as to indemnity or contribution does not affect their liability to the creditor, yet if the creditor has notice of an agreement between them whereby one guarantor agrees to be primarily liable, the creditor is bound to preserve the collateral for the one secondarily liable if he is compelled to pay. Palmer v. Purdy, 83 N.Y. 144, 147 (1880); Marshall v. Davies, 78 N.Y. 414 (1879); 57 N.Y. Jur. supra, §149 at 434.

Plaintiff's claim, therefore, that defendant breached its "fiduciary duty" or failed to use reasonable care is not supported by the facts or the law. Indeed, none of the cases relied upon by plaintiff in his brief involve co-guarantors or the transfer of collateral security to a guarantor who paid the debt. For example, in Signer v. First National Bank & Trust Co. of Covington, Kentucky, 455 F. 2d 382 (6th Cir. 1972) (App. Br., pp. 21, 32) collateral security was released to the debtor by a third party before the debtor had paid the debt to the secured creditor. Equally distinguishable on its face is the case of Grace v. Sterling Grace & Co., 30 A.D. 2d 61 (1st Dept. 1967) which involved a secured creditor's liability for the loss in value of collateral, debentures, where it failed to convert the debentures into common stock.

Finally, plaintiff's claim that defendant "cut off his right to redeem" the shares (App. Br., p. 33) is contrary to the law and the facts alleged. Since defendant did not sell the shares to Gloger, but merely transferred them to Gloger upon payment under his guaranty, any rights that plaintiff had continued as against Gloger. UCC§9-504(5). In any event, it appears from the bilateral agreement between plaintiff and Gloger that plaintiff in effect assigned his right to redeem to Gloger (Compl., par. 6, A-7). In this regard, plaintiff emphasizes, however, that defendant did not "elect to foreclose" on the shares but only demanded payment, and that plaintiff had requested defendant, after default, to return the shares to him if the loan were paid. (Compl., pars. 7, 11, A-10). Nevertheless, as the court below stated in holding that defendant acted with reasonable care:

"Perhaps it was in recognition of this apparent conflict between the two guarantors that the Bank refused to permit Gloger to take the collateral as a purchaser, but only, as appeared to be his right, as an assignee" (A-7).*

Manifestly, absent any factual allegations amounting to a failure to use reasonable care under Section 9-207(1) of

*It should be noted that although plaintiff in his affidavit submitted in opposition to the motion asserts that he did not pay the loan because accountings between Gloger and him showed that Gloger owed plaintiff money (A-26 to A-27), nowhere is it alleged that defendant had any notice or knowledge whatsoever of any accountings or moneys owing between plaintiff and Gloger.

the Uniform Commercial Code, the complaint fails to state a claim against defendant upon which relief can be granted. Therefore, under Rule 12(b)(6) FRCP, as a matter of law, the court below was correct in dismissing the complaint.

POINT IITHE DISTRICT COURT DID NOT ERR IN
DIRECTING JUDGMENT IN FAVOR OF
DEFENDANT DISMISSING THE COMPLAINT

It is settled that a complaint may be dismissed on motion if it is clearly without merit, and while the well-pleaded allegations of the complaint are deemed admitted, conclusions of law or unwarranted deductions of fact are not. 2A J. Moore's Federal Practice ¶12.08 at 2267-2271 (1975); Feinberg v. Leach, 243 F. 2d 64 (5th Cir. 1957). Where it is clear that plaintiff cannot show additional facts to cure the insufficiency, the complaint will be dismissed with prejudice. Penn Mart Realty Company v. Becker, 300 F. Supp. 731 (S.D.N.Y. 1969).

In the instant case, plaintiff's conclusory claim that defendant "aided and abetted Gloger in his assertion of ownership of the shares" (Compl., par. 12, A-11) flies in the face of the factual allegations that defendant "refused" to sell the shares to Gloger and would only transfer them to Gloger as a guarantor who paid the loan (Compl. par. 9, A-10). Thus, plaintiff's claim that defendant breached its duty to use reasonable care is not supported by the facts or the law as demonstrated in Point I, supra. Finally, plaintiff's

affidavit submitted in opposition to the motion below, which affidavit was not considered by the district court, only serves to underscore the frivolous nature of plaintiff's claim against defendant, and that if plaintiff has any claim it is as against Gloger. Where as here, plaintiff has stated all that he knows or believes and it is inadequate to state a claim, the district court may properly dismiss the complaint with prejudice.

CONCLUSION

It is respectfully submitted that for the reasons stated above, the judgment appealed from should be affirmed.

Respectfully submitted,

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